DOCKET FILE COPY ORIGINAL

RECEIVED

MAY 26 1999

FCC MAIL ROOM

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the matter of	)	
	)	
Implementation of the Local Competition Provisions of the Telecommunications Act of 1996	)))	CC Docket No. 96-98

AMERITECH COMMENTS

John T. Lenahan
Christopher M. Heimann
Gary L. Phillips
Larry A. Peck
Michael S. Pabian
Counsel for Ameritech
1401 H Street, NW
Suite 1020
Washington, DC 20005
(202) 326-3817

May 26, 1999

No. of Copies rec'd 0+12
List ABCDE

TABLE OF CONTENTS

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of the Local Competition	)	CC Docket No. 96-98
Provisions of the Telecommunications Act	)	
of 1996	)	

COMMENTS OF AMERITECH

I. INTRODUCTION AND SUMMARY.

On January 25, 1999, the United States Supreme Court vacated section 319 of the Commission's rules. Those rules, which were adopted in the *Local Competition Order*, had set forth a uniform national list of network elements that each incumbent local exchange carrier (ILEC) must make available on an unbundled basis to requesting carriers pursuant to section 251(c)(3) of the Communications Act.

The Court vacated these rules because it found that the Commission had failed to recognize that the unbundling obligations of an ILEC are subject to the "clear limits" of section 251(d)(2). The Commission, it held, began with the wrong premise – that section 251(d)(2) is merely a grant of discretionary authority, not a limiting standard - and then compounded its error by failing to give proper meaning to the substance of section 251(d)(2).

On remand, the Commission must begin anew. Its goal should not be to salvage its old unbundling list simply by beefing up its analysis *post hoc*. Instead, the Commission must determine, based on the factual evidence that has become available in the three years since the *Local Competition Order*, "*which* network elements must be made available taking into account the objectives of the Act and giving some substance to the 'necessary' and 'impair' requirements" of section 251(d)(2).[1]

As shown below, this evidence tells a compelling story. It demonstrates that, since the adoption of the *Local Competition Order*, broad competitive entry and explosive new investment has occurred in the local marketplace.

This evidence was discussed recently in testimony offered by Chairman Kennard before the United States Senate Committee on the Judiciary regarding the state of competition in the telecommunications industry three years after enactment of the 1996 Act. Chairman Kennard represented that "significant strides" had been made in local competition. He told the Committee:

> Local competitors are taking an increasing share of nationwide local service revenues. ...Local competitors continue to attract investment capital and deploy their networks. Industry sources report that 20 publicly traded competitive local exchange carriers (CLECs) have a total market capitalization of $33 billion – compared to 6 such companies with $1.3 billion of total market capitalization prior to the 1996 Act. And these competitors are working faster and working smarter. They continue to build fiber optic-based networks at a faster rate than the incumbents.[2]

Chairman Kennard's observations are echoed by the Council of Economic Advisers in its recently released Progress Report: Growth and Competition in U.S. Telecommunications, 1993-1998. That report provides the following overview of new competitive entry and investment in the nation's local markets:

[1] *AT&T Corp. v. Iowa Utils. Bd.*, 119 S. Ct. 721, 736 (1999) (emphasis in original) (*AT&T*).

[2] Statement of William E. Kennard, Chairman, FCC, Before the United States Senate Committee on the Judiciary, Subcommittee on Antitrust, Business Rights and Competition on State of Competition in the Telecommunications Industry Three Years After Enactment of the Telecommunications Act of 1996, Feb. 25, 1999, at 7.

> The number of switches owned by CLECs grew from 65 before the Act to nearly 700 by the end of 1998. As new entrants continue to build out their networks, the relative growth of facilities-based service will likely accelerate. Several sources of data show the CLECs to be building out their fiber networks at a fast clip, although the data are sketchy and incomplete. Merrill Lynch estimates from its survey of public CLECs that those companies added over 40,000 route miles of fiber to their networks in each of the first three quarters of 1998, and that the rate of deployment was increasing throughout that period. ...The marketplace clearly expects local competitors to flourish.[3]

These competitive strides are more than evident in the Ameritech region. Whereas in April 1997, there were only 22 competitive local switches in the Ameritech region, there are now 112 such switches (even excluding the large number of competitive packet switches) in Ameritech's service area – a 414% growth rate. The number of switches is expected to increase by another 32% to 150 by the end of 1999.

These switches have been deployed by 28 switch-based competitors, many of which have at least one switch in several states served by Ameritech. As might be expected, many of these switches are located in the largest cities in the Ameritech region. However, competitive switches also have been placed in many smaller cities, including Peoria, Illinois; South Bend, Indiana; Marquette, Michigan; Dayton, Ohio; and Oshkosh, Wisconsin.

Competitive local loops and transport have also shown dramatic increases since the *Local Competition Order*. Ameritech estimates competitive self-provisioning of loops has grown from approximately 100,000 in April 1997, to over 700,000 today, a growth of 853%. Several carriers have deployed fiber SONET rings and other wireline loops to serve large and medium-sized customers; others have deployed fixed wireless, PCS and cable loops.

---

[3] *Progress Report: Growth and Competition in U.S. Telecommunications 1993-1998,* The Council of Economic Advisers, February 8, 1999, at 17-18.

Still another indicator of widespread competitive entry is the extent to which CLECs are availing themselves of co-location. Co-location has increased in the Ameritech region from approximately 100 co-location arrangements in April of 1997 to over 800 today – a 600% growth rate. As a result, approximately 72% of Ameritech's access lines are addressable by an existing CLEC switch and established collocation arrangements.

These facts must be considered and evaluated with reference to the overarching objectives and language of the Act as the Commission fashions new unbundling rules. The overarching goals of the Act, as the Commission has often recognized, are twofold: (i) to bring consumers the benefits of meaningful competition, including higher quality services at economically rational prices, and (ii) to encourage new investment and innovation to accelerate deployment of advanced technologies and services on an efficient basis.

One of the most serious flaws in the Commission's initial unbundling rules is that they were not reasonably designed to further either of these goals. Instead of laying the groundwork for meaningful competition - the kind of competition that can serve as an engine for lower prices, better service, innovation and investment - the Commission sought immediate gratification: entry by as many entities as possible as quickly as possible.

If the Commission's unbundling rules are truly to promote the goals of the Act, the Commission must refocus those rules to these ends. It must understand that meaningful competition results not from policies that seek the fastest possible entry by the maximum number of competitors, but from policies that promote efficiency and product differentiation. The goal should be to encourage efficient entry by those who have the capacity to "build a better mousetrap," and then to incent them to do so.

To this end, the Commission should require ILECs to provide access to network elements only to the extent reasonably efficient competitors require such access in order to enter the market in a reasonably timely fashion and earn an economic return on capital over the life of their investment (*i.e.*, a normal economic profit). Specifically, Ameritech proposes the following test under the "impair" standard that should be applied to all network elements:

> *Unbundling of a nonproprietary network element is required if the lack of access to that element would prevent a reasonably efficient competitor from providing the services it seeks to offer within two years and from earning a competitive return on capital (i.e., a normal economic profit) in the provision of those services over the life of its investment.*

To the extent a network element to which access must be provided is proprietary in some respect – *i.e.*, it uses intellectual property that can be protected by patent, copyright, trade secret, or other laws - a second review must occur. That second review determines whether a reasonably efficient CLEC requires access to that proprietary component (taking into account the availability of alternatives) in order to make use of the network element as a whole. If it does not, only the non-proprietary aspects of the network element must be provided.

The best way to implement these tests is through uniform national standards. Ameritech proposes precisely such standards in these comments. Because the considerations that affect the feasibility of using alternative facilities vary from element to element, so too must the test. For each element, however, Ameritech proposes standards that: (i) are easy to administer, and (ii) look to relevant market data for evidence of the feasibility of earning a normal economic profit without using ILEC facilities. Ameritech sets forth below the appropriate standard for each network element.

- **Switching** – ILECs should not be required to provide access to unbundled local switching in any wire center in which collocation is available that is located in a rate center that is being served by at least one CLEC circuit switch. ILECs should not be required to make their routing tables available in any area.

- **Interoffice Transport** – ILECs should not be required to make interoffice transport available: (1) in any wire center serving 40,000 or more lines with existing collocation, or (2) in *any* central office with collocation if competitive interoffice transmission facilities have actually been deployed in the wire center.

- **Local Loops** – Ameritech generally agrees that local loops should be made available at this time, except in wire centers with 40,000 or more lines and in which alternative loop facilities have been deployed.

- **Operator Services/Directory Assistance** – Operator services and directory assistance facilities and functionalities should not be unbundled in any geographic market in the country.

- **Signaling Networks** – The Commission should not require ILECs to provide access to their signaling networks in any market in which switching is not required to be provided on an unbundled basis.

- **Call-Related Databases** – Call-related databases should not be unbundled in any geographic market in the country.

- **Advanced Intelligent Network** – Absent any demonstrated need for access to the AIN platform, the Commission should decline to require ILECs to provide such access on an unbundled basis. At a minimum, the Commission should decline to require ILECs to provide access to AIN services, even if it continues to require access to the AIN platform.

- **Advanced Network Capabilities** – ILECs should not be required to unbundle new equipment used to provide advanced telecommunications capability, including DSLAMs, packet switches, and any other new technology that may yet be developed for such purposes.

These standards will result in unbundling requirements that are most faithful to the letter and spirit of the Supreme Court decision and the pro-competitive, pro-investment purposes of the 1996 Act. They afford CLECs access to those network elements CLECs need to compete viably in the marketplace, but, at the same time, are narrowly tailored to maximize incentives for competition and investment.

II. BACKGROUND

a. The 1996 Act.

The 1996 Act pursues two overarching goals. One is to "promote competition and reduce regulation in order to secure lower prices and higher quality service for American telecommunications consumers and encourage the rapid deployment of new telecommunications technologies."[4] The other "fundamental goal … is to promote innovation and investment by all participants in the telecommunications marketplace[.][5] The Act seeks to achieve these goals by eliminating barriers to efficient competition and to private investment in all telecommunications markets.

Section 251 of the Act, consistent with these goals, facilitates the growth of competition in local telephone markets by requiring incumbent local exchange carriers ("ILECs") to: (1) interconnect with competitors' networks; (2) sell retail services to competitors at wholesale rates; and (3) share its facilities with competitors by providing "access to network elements on an unbundled basis."[6]

This latter "sharing" obligation is not unlimited. Rather, section 251(d)(2) establishes "clear limits" on the Commission's authority to order access to unbundled network elements. Section 251(d)(2) provides that "in determining what network elements should be made available … the Commission shall consider, at a minimum, whether - (A) access to such network elements as are proprietary in nature is necessary; and (B) the failure to provide access to such network

---

[4] Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56, at Preamble, *codified at* 47 U.S.C. §§ 151 *et seq.* (1996 Act).

[5] *Deployment of Wireline Services Offering Advanced Telecommunications Capability,* First Report and Order and Further Notice of Proposed Rulemaking, CC Docket No. 98-147, FCC 99-48, released March 31, 1999 (*Advanced Services Order)* at para. 1.

[6] 47 U.S.C. § 251(c)(3).

elements would impair the ability of the telecommunications carrier seeking access to provide the services it seeks to offer."[7]

[7] *Id.* at § 251(d)(2).

b. The Commission's Initial Unbundling Requirements

On August 8, 1996, the Commission adopted the *Local Competition Order*,[8] which established rules to implement the local competition provisions of the 1996 Act, including the unbundling requirement in section 251(c)(3).[9] In that order, the Commission considered how the statutory unbundling standards in section 251 should apply. It concluded that section 251(c)(3) imposed on incumbent LECs a duty to provide competitors access to "all network elements for which it is technically feasible to provide access on an unbundled basis."[10] It further concluded that the necessary and impair standards in section 251(d)(2) simply conferred upon the Commission discretion to "refrain from requiring ILECs to provide all network elements for which it is technically feasible to provide access on an unbundled basis."[11]

Although the Commission defined the term "necessary" to mean "an element is a prerequisite for competition," it declined to require competing carriers to demonstrate "a heavy burden of need" before mandating access to proprietary elements.[12] It also declined to examine whether a requesting carrier could obtain proprietary elements from a source other than the incumbent on the ground that requiring a competing carrier to obtain proprietary elements outside the ILEC's network could "generate delay and higher costs for new entrants."[13] It instead determined that an ILEC must unbundle proprietary elements unless it can demonstrate

---

[8] *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-98, First Report and Order, 11 FCC Rcd 15499 (1996) (*Local Competition Order*).

[9] *Id.* at 15616.

[10] *Id.* at 15640-41.

[11] *Id.* at 15641.

[12] *Id.*

that a requesting carrier could offer the service it seeks to offer using "other, nonproprietary unbundled elements within the incumbent's network."[14]

The Commission held that the term "impair" means, *inter alia,* "to diminish in value." [15] Based on this definition, it declared that it would consider the "impairment" standard to be satisfied if "the failure of an incumbent to provide access to a network element would decrease the quality, or increase the financial or administrative cost of the service a requesting carrier seeks to offer compared with providing that service over other unbundled elements in the incumbent LEC's network."[16] Once again, it declined to consider whether alternative sources of network elements were available outside the incumbent's network.

After enunciating its interpretation of the statutory unbundling standards in section 251(d)(2), the Commission applied its interpretation to incumbent LECs' networks and established a uniform, national list of unbundled network elements.[17] Specifically, it required ILECs to make available, on an unbundled basis, local loops, network interface devices, local switching, interoffice transmission facilities, signaling networks and call-related databases, operations support systems, and operator services and directory assistance.[18]

---

[13] *Id.*at 15462.

[14] *Id.*; *see also* 47 C.F.R. § 51.317(b) (vacated by *Iowa Utils. Bd. v. FCC,* 120 F.3d 753, 810 (D.C. Cir. 1997) (*Iowa Utils. Bd.)).*

[15] *Local Competition Order,* 11 FCC Rcd at 15453.

[16] *Id.*

[17] *Id.* at 15683 (noting that states could prescribe additional network elements, provided that they follow the Commission's interpretation of the statutory unbundling standards).

[18] *Id.*, 47 C.F.R. § 51.319.

c. **The Supreme Court Opinion**

Upon review of the Commission's order,[19] the Supreme Court vacated section 51.319, concluding that the Commission "did not adequately consider the 'necessary and impair' standards."[20] The Court determined that, in viewing section 251(d)(2) as merely a grant of discretionary authority to create an exception to an incumbent's obligation to turn over as much of its network as was technically feasible, the Commission fundamentally began with the wrong premise.[21] Section 251(d)(2), the court said, "does not authorize the Commission to create isolated exemptions from some underlying duty to make all network elements available."[22] Rather, it imposes "clear limits"[23] and "requires the Commission to determine on a rational basis *which* networks elements must be made available, taking into account the objectives of the Act and giving some substance to the "necessary" and "impair" requirements."[24]

The Court found that, not only had the Commission failed to give sufficient weight to section 251(d)(2), but that it had misconstrued the substance of that provision in two key

---

[19] Several parties filed challenges to the Commission's unbundling rules, which were consolidated in the Eighth Circuit. The Eighth Circuit struck down significant portions of the rules, but rejected challenges to section 51.319 and the Commission's interpretation of "necessary" and "impair." *Iowa Utils. Bd.*, 120 F.3d at 808, *et seq.* Among other things, the Court vacated section 51.311(c) (requiring ILECs to provide unbundled network elements, and access to such elements, at levels of quality superior to those which the ILECs provide to themselves), sections 51.315(c) & (d) (requiring ILECs to combine network elements that are not already combined in the ILECs' networks, and to combine unbundled elements with elements possessed by a requesting carrier), and a portion of section 51.317 (creating a presumption that a network element must be unbundled if it is technically feasible to do so). *Id.* at 810-15. Although the Supreme Court granted review of the Eighth Circuit's decision, the Eighth Circuit's vacatur of the foregoing rules was not challenged and therefore is the law of the land.

[20] *AT&T* 119 S. Ct. at 734.

[21] *Id.* at 736

[22] *Id.*

[23] *Id.* at 738

[24] *Id.* at 736 (emphasis in original).

respects. First, it had failed properly to consider evidence of supply substitutability because it had "blind[ed] itself to the availability of elements outside the incumbent's network."[25] According to the Court, "[t]hat failing alone would require the Commission's rule to be set aside."[26]

Second, the Commission erroneously "assum[ed] that *any* increase in cost (or decrease in quality) imposed by denial of a network element renders access to that element "necessary," and causes the failure to provide that element to "impair" the entrant's ability to furnish its desired services."[27] The Court explained that an entrant's *ability* to provide a service is not "impaired" by lack of access to an element merely because it is marginally less profitable than it would be if it obtained such access, and that an element is not "necessary" merely because obtaining access to the element would marginally increase the entrant's profitability.[28]

The Court elaborated on how much of an increase in cost or decrease in quality would give rise to necessity or impairment in responding to an analogy offered by Justice Souter in dissent. Justice Souter had posited that "one can say his ability to replace a light bulb is 'impaired' by the absence of a ladder, and that a ladder is 'necessary' to replace the bulb, even though one 'could stand instead on a chair, a milk can, or eight volumes of Gibbon.'"[29] The

---

[25] *Id.* at 735.

[26] *Id.*

[27] *Id.*

[28] *Id.* ("An entrant whose anticipated profits from the proposed service are reduced from 100% of investment to 99% of investment has perhaps been "impaired" in its ability to amass earnings, but has not *ipso facto* been 'impair[ed] … in its ability to provide the services it seeks to offer'; and it cannot realistically be said that the network element enabling it to raise its profits to 100% is 'necessary.'")

[29] *Id.* at 739 (Souter, J., concurring in part and dissenting in part). Although conceding that the justification for the Commission's interpretation of "necessary and impair" was weak, Justice Souter would have upheld Rule 319 on

Court found that this analogy missed the point, noting that "the proper analogy, it seems to us, is . . . a ladder tall enough to enable one to [replace a light bulb], *but not without stretching one's arm to its full extension*. A ladder one-half inch taller is not, 'within the ordinary and fair meaning of the word' . . . 'necessary,' nor does its absence 'impair' ones ability to do the job."[30]

The Court's meaning is clear. If entrants could change the bulb using their own (or someone else's) ladder, even if they had to stretch their arms to full extension, access to the ILEC's ladder would not be "necessary," and failure to obtain access to the ladder would not "impair" entrants ability to offer the services they seek to provide. By the same token, if competitors could earn a an economic return on capital[31] using facilities other than those of the ILEC, access to the ILEC's facilities would not be necessary, and the failure to obtain access to those facilities would not impair their ability to provide the services they seek to offer.

III. ON REMAND, THE COMMISSION MUST CLOSELY FOLLOW THE TEACHINGS OF THE COURT.

As the Supreme Court's opinion makes clear, the Commission's initial unbundling requirements were fundamentally flawed. The Commission began with the wrong premise – that section 251(d)(2) is a grant of discretionary authority, not a limiting standard - and then compounded its error by failing to give proper meaning to the substance of section 251(d)(2).

On remand, the Commission must begin anew. Its goal should not be to salvage its old unbundling list simply by beefing up its analysis *post hoc*, but to determine, based on an analysis

---

the ground that the terms "necessary and impair" are ambiguous, and that the Commission's interpretation was entitled to *Chevron* deference.

[30] *Id.* at note 11 (emphasis added).

[31] *See* Affidavit of Jerry A. Hausman and J. Gregory Sidak in Response to Second Further Notice of Proposed Rulemaking, attached to United States Telephone Association Comments, at para. 38. An economic return on capital is sometimes referred to as "zero economic profit." *Id.* We also refer to it herein as a "normal economic profit."

of the considerable body of factual evidence that has become available in the three years since the *Local Competition Order*, "*which* network elements must be made available taking into account the objectives of the Act and giving some substance to the 'necessary' and 'impair' requirements."[32] This analysis must be informed, first and foremost, by a recognition that section 251(d)(2) establishes "clear limits" on the obligation of an incumbent to unbundle its network. Indeed, the Court made clear that a failure to apply these limits would be entitled to no *Chevron* deference.[33]

The Commission must also, of course, give proper substance to these statutory limits. For starters, it must rectify a number of critical errors it made in the *Local Competition Order*. Most obviously, the Commission must interpret section 251(d)(2) so as to give meaning to the clear limits that provision establishes. To this end, it must consider: (1) whether a network element is reasonably and practicably available from sources outside the incumbent's network (including through self-provision); and (2) whether the lack of access to that element would sufficiently increase competitors' costs or decrease their quality such that they would be impaired in their *ability* to provide the service in question.

In addition, the Commission must interpret section 251(d)(2) so as to further the "objectives of the Act."[34] The Commission did not do so in the *Local Competition Order*. Instead, it relied on an unusual dictionary definition of "impair" coupled with a distorted vision of how to achieve the objectives of the Act. To the extent the Commission relied heavily on a dictionary definition to interpret the impair standard, that approach was wrong. Just as

---

[32] *AT&T,* 119 S. Ct. at 736 (emphasis in original).

[33] *AT&T,* 119 S. Ct. at 738.

"[d]ictionary definitions are inadequate to resolve the scope of the long distance restriction,"[35] so too are they inadequate in and of themselves to resolve the meaning of section 251(d)(2).[36] To the extent the Commission misapprehended the way to achieve the objectives of the Act, it must refine its analysis. In particular, it must correct two analytical errors that compromised the unbundling rules adopted in the *Local Competition Order*. First, it must promote competition, rather than simply maximize the *number* of entrants in the market. Second, the Commission must consider the societal costs, including adverse effects on competition, investment and innovation, of overbroad unbundling requirements.

Finally, in giving content to the substance of the Act, the Commission must take stock of the essential facilities doctrine. Although the Court did not address whether section 251(d)(2) codifies this doctrine *per se*, the Court adopted the key precepts of this doctrine. The essential facilities doctrine, therefore, can no longer be ignored by the Commission, as it was in the *Local Competition Order*. It should guide, if not control, the Commission's decision in this proceeding.

a. The Commission Must Construe Section 251(d)(2) With Reference to the Objectives of the Act.

The overarching goals of the Act, as the Commission has often recognized, are twofold: (i) to bring consumers the benefits of meaningful competition, including higher quality services at economically rational prices, and (ii) to encourage new investment and innovation to

---

[34] *Id.*

[35] *US West Communications, Inc. v. FCC,* No. 98-11468 (D.C. Cir.), Brief for Respondents at 41.

[36] Indeed, Justice Souter's purely textual analysis of the limiting standard in section 251(d)(2), which he found supported the Commission's initial unbundling rules, was rejected by each of the other seven members of the Court that participated in this decision. (Justice O'Connor took no part in the consideration or decision of the case.)

accelerate deployment of advanced technologies and services on an efficient basis.[37] These twin goals are reflected in the text and legislative history of the Act[38] and have been repeatedly acknowledged formally and informally by the Commission.[39] They are also reflected in President Clinton's comments when he signed the Act into law on February 8, 1996, calling it an important step in the Administration's commitment "to reform our telecommunications laws in a manner that leads to competition and private investment, promotes universal service and open access to information networks, and provides for flexible government regulation."[40]

One of the most serious flaws in the Commission's initial unbundling rules is that they were not reasonably designed to further either of these goals. Instead of laying the groundwork for meaningful competition - the kind of competition that can serve as an engine for lower prices, better service, and innovation and investment - the Commission sought immediate gratification:

---

[37] The Court directed the Commission to interpret section 251(d)(2) with reference to these goals because it understood the inherent link between section 251(d)(2), on the one hand, and competition and investment, on the other. As Commissioner Powell notes in his separate statement: "[U]nderlying the Court's insistence that section 251(d)(2) establishes a limiting standard is its understanding that facilitating competition under the 1996 Act requires a careful balance between aiding new entrants and not making access to the incumbent's network too easy." *Notice* (Separate Statement of Commissioner Michael K. Powell (Powell Statement) at 2.)

[38] *See e.g.* 1996 Act, Pub L. No. 104-104 at Preamble and Section 706. *See also* Joint Managers' Statement, S. Conf. Rep. No. 104-230, 104th Cong. 2d Sess. 113 (1996) (the purpose of the Act is "to provide for a pro-competitive de-regulatory national policy framework designed to accelerate rapidly private sector deployment of advanced telecommunications and information technologies and services to all Americans by opening all telecommunications markets to competition).

[39] *See e.g. Advanced Services Order supra* at para. 1. *See also Inquiry Concerning the Deployment of Advanced Telecommunications Capability to all Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996,* Notice of Inquiry, CC Docket 98-146, FCC 98-187, released August 7, 1998 at para. 1 ("We intend for advanced technology to have every opportunity to flourish[.] Advanced capability and services can create investment, wealth, and jobs. They can meaningfully improve the nation's productivity and educational, social, and health care services. They can create a more productive, knowledgeable, and cohesive nation.") *And see "A Networked Future for all Americans,"* Address of FCC Chairman William E. Kennard to National Telephone Cooperative Association, Feb. 10, 1999 at 4 ("Make no mistake about it: linking [rural communities] to the networks of tomorrow is crucial to this nation's livelihood and even survival); Statement of Commissioner Susan Ness before the House Subcommittee on Telecommunications, Trade and Consumer Protection, March 17, 1999 at 6-7.

[40] *See Progress Report: Growth and Competition in U.S. Telecommunications 1993-1998,* The Council of Economic Advisers, February 8, 1999 at 4.

entry by as many entities as possible as quickly as possible. By settling for mere rivalry, the Commission failed to promote true competition.

It dismissed outright the second principal goal of the Act – promoting investment and innovation. For one thing, it failed even to acknowledge the disincentives to investment caused by access to nonproprietary network elements. And while it did "acknowledge that prohibiting incumbents from refusing access to proprietary elements could reduce their incentives to offer innovative services,"[41] it declined to require a "heavy burden of need"[42] for access to such elements. Indeed, as a general proposition, the Commission failed to consider *any* of the social costs of unbundling requirements.

If the Commission is to fulfill the Court's mandate that it construe the limitations in section 251(d)(2) with reference to the "objectives of the Act," it must correct both of these errors. It must distinguish between true competition and simply increasing the number of providers . It must also give proper weight to the costs of unbundling requirements, including, but not limited to, the chilling effects those requirements have on innovation and investment.

1. In order to Promote the Act's Overarching Goals of Bringing to Consumers the Benefits of Competition and of Advanced Technologies and Services, the Commission Must Recognize the Difference Between Promoting Competition and Maximizing the Number of Competitors in the Marketplace.

As noted, the Commission's initial unbundling rules were driven by the notion that the best way to promote competition is to maximize both the number of local exchange competitors and the speed with which they can enter the marketplace. Because these rules reflected the view

---

[41] *Local Competition Order*, 11 FCC Rcd at 15642.

[42] *Id.*

that competition is diminished by the elimination of even one rival, they were designed, not to ensure that efficient competitors have the opportunity to compete, but to protect even inefficient competitors.

This solicitude for competitors, rather than competition, is incompatible with the Court's mandate that the Commission interpret section 251(d)(2) in a manner that furthers the goals of the Act. As stated by Judge Posner:

> The policy of competition is designed for the ultimate benefit of consumers rather than of individual competitors, and a consumer has no interest in the preservation of a fixed number of competitors greater than the number required to assure his being able to buy at the competitive price.[43]

Similarly, Justice (then Judge) Breyer wrote that the term 'anticompetitive'

> refers not to actions that merely injure individual competitors, but rather to actions that harm the competitive process, a process that aims to bring consumers the benefits of lower prices, better products, and more efficient production methods.[44]

These are not simply the musings of a few economically-oriented judges. The Supreme Court itself has repeatedly recognized the distinction between protecting competitors and protecting competition. For example, in 1993, the Court stated:

> The purpose of the [Sherman Act] is not to protect businesses from the working of the market; it is to protect the public from the failure of the market. The law directs itself not against conduct which is competitive, even severely so, but against conduct which unfairly tends to destroy competition itself. It

---

[43] *Marrese v. American Academy of Orthopaedic Surgeons*, 706 F.2d 1488, 1497 (7th Cir. 1983) (Posner, J.). *See also Products Liability Ins. Agency, Inc. v. Crum & Forster Ins. Cos.*, 682 F.2d 660, 664 (7th Cir. 1982) ("The consumer does not care how many sellers of a particular good or service there are; he cares only that there be enough to assure him a competitive price and quality.")

[44] *Interface Group, Inc. v. Massachusetts Port Authority*, 816 F.2d 9, 10 (1st Cir. 1987) (citing 7 Phillip E. Areeda, *Antitrust Law*, ¶ 1500, pp. 362-63.

does so not out of solicitude for private concerns but out of concern for the public interest.[45]

The Commission as well has long recognized the distinction between promoting competition and promoting the welfare of individual competitors. For example, in its *Section 706 Order*, the Commission stated: "The role of the Commission is not to pick winners or losers, or select the 'best' technology to meet consumer demand, but rather to ensure that the marketplace is conducive to investment, innovation, and meeting the needs of consumers."[46] Similarly, in both the *AT&T Streamlining Order* and the *AT&T Reclassification Order*, the Commission rejected arguments that AT&T should be denied increased regulatory flexibility in order to make it "easier for others to compete." Distinguishing between promoting competition and promoting the interests of AT&T's competitors, the Commission stated "no one has shown that [AT&T's alleged] advantages preclude the effective functioning of the [marketplace]."[47]

The reason courts, regulators, and economists all recognize the distinction between promoting competition and maximizing entry is simple. The whole point of competition is to spawn greater efficiency and innovation as firms strive to differentiate themselves from their competitors. A weak rival, though, will have no such effect on its competitors. Thus regulatory policies that prop up, or even create weak competitors, or that seek to promote entry without

[45] *Spectrum Sports, Inc. v. McQuillan,* 506 U.S. 447, 548 (1993). *See also Atlantic Richfield Co. v. USA Petroleum Co.,* 495 U.S. 328, 338 (1990); *Cargill, inc. v. Monfort of Colorado, Inc.,* 479 U.S. 104, 116-17 (1986); *Associated General Contractors of Cal., Inc. v. Carpenters,* 459 U.S. 519, 539-40 (1983).

[46] *Deployment of Wireline Services Offering Advanced Telecommunications Capability,* CC Docket No. 98-147, FCC 98-188, Memorandum Opinion and Order, released August 7, 1998 at para. 2. Just a few months ago, Commissioner Ness testified that one of her guiding principles is that "[c]onsumer interests, not those of any industry player, should be paramount. The Commission should not try to pick winners or losers, either individually or by industry segment. Nor should we be tempted by short-term "fixes" that impede long-term objectives." Statement of Commissioner Susan Ness before the House Subcommittee on Telecommunications, Trade and Consumer Protection, March 17, 1999 at 6.

[47] *See Competition in the Interstate, Interexchange Marketplace,* Report and Order, 6 FCC Rcd 5880 (1991) at para. 61.

regard to the efficiency of new entrants, do not bring consumers the benefits of competition. As stated by Areeda and Hovenkamp, "'competition' means not merely the existence of rivalry, but circumstances tending toward increased output and reduced prices."[48] Thus, "[a]lthough effects on [a] plaintiff competitor can be congruent with the effect on competition, this can hardly be assumed and the emphasis must always be on the latter."[49]

If the Commission's unbundling rules are truly to promote the goals of the Act – competition that brings innovation and investment – the Commission must refocus those rules to these ends. It must understand that meaningful competition results not from policies that seek the fastest possible entry by the maximum number of competitors, but from policies that promote efficiency and product differentiation. The goal should be to encourage efficient entry by those who have the capacity to "build a better mousetrap," and then to incent them to do so.

To this end, the Commission's unbundling rules must be tailored to address the needs of reasonably efficient competitors. If reasonably efficient competitors require a network element to (i) enter the market in a reasonably timely fashion or (ii) earn an economic return on capital over the life of their investment (*i.e.*, a normal economic profit), that element ought to be made available. If they do not, there is no public benefit in requiring mandatory unbundling of that element in order to address the needs of a less efficient competitor. Competitors that are not reasonably efficient do not drive lower prices or better service. In a competitive marketplace, they do not survive at all, and policies designed to prop them up do not further meaningful competition and do not benefit consumers.

---

[48] IIIA Phillip E. Areeda and Herbert Hovenkamp, *Antitrust Law* ¶ 773a at 199 (1996) (*Areeda*).

[49] *Id. See also Notice,* Powell Statement at 2 (Making … access too easy or attractive will only ensure that the entrant's relationship to the incumbent is characterized more by one-sided dependence than true rivalry.")

Ironically, in the *Local Competition Order*, the Commission recognized this. In discussing the obligation of ILECs to provide network elements on terms and conditions that are just, reasonable, and nondiscriminatory, it stated that ILECs must "provide unbundled elements under terms and conditions that would provide an *efficient* competitor with a meaningful opportunity to compete."[50] The Commission should heed its own words. Unbundling requirements that cater to the lowest common denominator do not merely fail to promote competition, as discussed below, they harm it.[51]

2. The Commission Must Also Recognize That Unbundling Requirements Impose Costs That Directly Implicate the Goals of the Act.

Not only must the Commission recognize the distinction between increased rivalry and increased competition, it must also recognize that unbundling requirements impose costs. These costs include, not only the obvious costs of regulation and the network modifications necessary to comply with unbundling mandates, but chilling effects on competition and incentives to invest in advanced infrastructure.

In the *Local Competition Order*, the Commission all but ignored these costs.[52] Spinning its own variation on the old adage, "what's good for General Motors is good for the country," the Commission proceeded under the assumption that "what's good for CLECs is good for

[50] *Local Competition Order,* 11 FCC Rcd at 15660 (emphasis added).

[51] To be sure, section 251(d)(2)(B) refers only to "the telecommunications carrier seeking access." To read that provision, however, as establishing a lowest common denominator standard would be absurd. The purpose of the Act is to bring consumers the benefits of meaningful competition - economically rational prices, better service, more innovation, and more investment - not to open the market to every entity that decides to give local service a whirl. Implicit in section 251(d)(2), therefore, is the notion that the needs of telecommunications carriers seeking access must be gauged with reference to the needs of a reasonably efficient carrier.

competition." That was a serious mistake, and one that cannot be repeated if the Commission is to remain faithful to the Court's mandate to construe section 251(d)(2) with reference to the pro-competitive policies of the Act. As Justice Breyer observed:

> [T]he statute's unbundling requirements, read in light of the Act's basic purposes, require balance. Regulatory rules that go too far, expanding the definition of what must be shared beyond that which is essential to that which merely proves advantageous to a single competitor, risk costs that, in terms of the Act's objectives, may make the game not worth the candle.[53]

The costs of mandatory unbundling requirements are widely recognized in economic literature and antitrust jurisprudence.[54] One such cost is that sharing tends to supplant meaningful competition. When a new entrant shares an incumbent's facilities, that new entrant has only a limited opportunity to differentiate its offering from that of the incumbent. To be sure, the entrant can establish a different rate structure or offer new billing options and the like, but the arena in which competition takes place is limited. Professors Aron and Harris put it this way:

> Consumer welfare is enhanced if competitors can produce the same products as the incumbent more efficiently, if the entrant can differentiate its product from that of the incumbent in ways that appeal to consumers or if entrants can innovate to produce new and different services. The more the entrant relies on the incumbent's network, the less these benefits are possible[.][55]

---

[52] For example, the Commission specifically acknowledged that requiring incumbents to provide access to proprietary elements "could reduce their incentives to offer innovative services," but then gave no weight to this consideration whatsoever. *See Local Competition Order,* 11 FCC Rcd at 15642.

[53] *AT&T,* 119 S. Ct. at 753-54 (Breyer, J. concurring).

[54] It is because of these considerable costs that some economists have found fault with certain applications of the essential facilities doctrine. In this regard, Ameritech is aware of no critique that suggests the essential facilities doctrine should be broadened; rather, to the extent the doctrine has been questioned it has been questioned by economists who claim that sharing should be required in only the most narrow of circumstances *See* Phillip Areeda, *Essential Facilities: An Epithet In Need of Limiting Principles,* 58 Antitrust L. J. 841, 852 (1990) ("There is no general duty to share. Compulsory access, if it exists at all, is and should be very exceptional. ... No one should be forced to deal unless doing so is likely substantially to improve competition in the marketplace").

[55] *See* Joint Affidavit of Debra J. Aron and Robert G. Harris, attached hereto as Exhibit A (Aron/Harris Affidavit) at 17.

Justice Breyer likewise recognized this phenomenon, pointing out in his concurring opinion that:

> [i]t is in the *un*shared, not in the shared, portions of the enterprise that meaningful competition would likely emerge. Rules that force firms to share *every* resource or element of a business would create, not competition, but pervasive regulation, for the regulators, not the marketplace, would set the relevant terms."[56]

These observations are right on the mark. If the Commission is to interpret the unbundling requirements in a way that promotes competition, the Commission must recognize the difference between meaningful competition and regulatory arbitrage. While regulatory arbitrage may be the route to the fastest possible entry by the largest number of providers, the Commission should not, as Commissioner Ness told Congress, be tempted by short-term fixes that impede long-term objectives."[57]

That is not to say that mandatory unbundling serves no valid purpose. To the contrary, unbundling requirements can and do promote competition and enhance consumer welfare to the extent they permit new entrants access to facilities that they could not reasonably and practicably duplicate on their own. When mandatory sharing requirements extend, however, to facilities that a reasonably efficient competitor ought to be able to purchase or construct itself, those requirements tend to reduce the realm in which firms compete. The Commission, therefore, must be cognizant of those elements that can reasonably be duplicated and those that cannot and interpret the necessary and impair tests with an eye to distinguishing between the two.

---

[56] *AT&T,* 119 S. Ct. at 754 (Breyer, J. concurring).

[57] Statement of Commissioner Susan Ness before the House Subcommittee on Telecommunications, Trade and Consumer Protection, March 17, 1999 at 6.

Another cost of mandatory unbundling – particularly at total element long run incremental cost (TELRIC) rates - is that it reduces the incentives of new entrants to develop their own alternative inputs. This effect is well recognized in the economics literature,[58] and it is most pronounced in the field of telecommunications. In the telecommunications field, which is marked by rapid innovation and competing technologies, investment is risky, as it may commit the entrant to a particular technology that later reveals itself to be inferior to other technologies or, even if not technically inferior, less favored by customers. Given these risks, new entrants may well decide to forestall their own investments and efforts at innovation to see which technologies pan out.

While this option of hedging one's bets is certainly attractive to new entrants, it does not promote consumer welfare. The process of economic growth is fueled by risk taking, which entails success for some and failure for others. It is not the role of the Commission to provide artificial protection from such risks. As stated by Professors Aaron and Harris:

> It is wrong-headed and destructive public policy to provide artificial protection from risk. The purpose of unbundling is to permit entry if it otherwise would be infeasible; it is *not* to limit entrants' risk, particularly in a market where risk is the seed of innovation and where innovation lies at the heart of the benefits that should arise from competition.[59]

Not only do mandatory sharing requirements reduce the incentives of new entrants to deploy their own facilities, such requirements may also have ripple effects – discouraging *other*

---

[58] *See, e.g.,* Alfred E. Kahn, *Letting Go: Deregulating the Process of Deregulation,* MSU Public Utilities Papers, 1998 at 48:

> if potential competitors can obtain from incumbents, at regulatorily-prescribed prices, not just facilities and services that are naturally monopolistic but any and all others – present and future – that could feasibly be supplied independently, the incentive of incumbents to innovate and of competitors to provide their own will be attenuated.

[59] Aaron/Harris Affidavit at 19.

new entrants who might otherwise have deployed their own facilities from doing so. Areeda and Hovenkamp offer the following illustration:

> [S]uppose [a] dominant natural gas seller owns a gas pipeline and the plaintiff, a small producer wishes to share. Suppose this particular plaintiff can show that its own gas supplies are too small to warrant construction of a pipeline, and the line is essential to its own viability. However, other gas fields are in the area and other firms could readily construct pipelines to serve the market served by the defendant. In this case, the defendant's pipeline is "essential" to the plaintiff's survival as a business, but it is hardly essential to increased competitiveness in the market, *and granting the plaintiff's request reduces the incentive of others in a similar [position] to build their own lines.*"[60]

Unbundling requirements can also have the perverse effect of crowding out entrants who might, in the long run, offer productive efficiencies in favor of entrants that can turn higher short-term profits by piggy-backing on an incumbent's network.

Of course, these costs are merely academic to the extent unbundling requirements are limited to facilities that new entrants could not reasonably or practicably duplicate on their own. But as Areeda and Hovenkamp note,

> it could be extremely serious to the point of undermining antitrust goals in the case where either the [entrant] or some other rival could enter the market by some alternative not requiring the sharing of the [incumbent's] facility. In that case, a court injunction requiring the [incumbent firm] to share actually perpetuates the monopoly by reducing the incentive for development of realistically available competitive alternatives.[61]

A third cost of unbundling requirements is that they diminish the incentives of the incumbent to innovate and become more efficient. The engine of the competitive process is the ability of firms, by developing efficiencies and innovative new products and services, to

[60] *Areeda*, at ¶ 773b3, pp. 206-07 (emphasis added).

[61] *Id.* at ¶ 771b, p. 176.

differentiate themselves from their competitors. Unbundling requirements deny incumbents that ability.[62] As Justice Breyer notes:

> [A] sharing requirement may diminish the original owner's incentive to keep up or to improve the property by depriving the owner of the fruits of value-creating investment, research, or labor. And as one moves beyond the sharing of readily separable and administrable physical facilities, say, to the sharing of research facilities, firm management, or technical capacities, these problems can become more severe. ...And the more serious they become, the more likely they will offset any economic or competitive gain that a sharing requirement might otherwise provide.[63]

The effect of unbundling requirements on an incumbent's investment incentives have also been noted by Kathleen Wallman, Former Common Carrier Bureau Chief and Deputy White House Counsel. Focusing specifically on advanced services, the ubiquitous deployment of which is an overarching goal of the Act, she stated:

> Do we really mean to say that any carrier that is thinking of building a new broadband network should count on being able to recover, from day one of operation, only the forward looking costs of their brand new network? I don't think so. No rational, efficient firm would take that deal. And that would be *our* collective loss, not just theirs.[64]

Of course, the Commission is quite familiar with the disincentives to investment created by unbundling obligations, as these disincentives were explained in great detail by AT&T in the *AT&T/TCI Merger Proceeding*.[65] In that proceeding, AT&T went so far as to claim that its

---

[62] *See* Aron/Harris Affidavit at 19: ("The rewards of successful innovation are diminished (as entrants will demand unbundled access to successful innovations at rates that do not reflect the innovation risks), while the incumbent alone bears the risk of failure.")

[63] *Id.* at 754 (Breyer, J. concurring), citing 1 H Demsetz, *Ownership, Control, and the Firm: The Organization of Economic Activity* 207 (1988).

[64] Remarks of Kathleen Wallman to the Annual Convention of the National Association of Regulatory Utility Commissioners, Boston, Mass., Nov. 11, 1997 (emphasis in original).

[65] *See Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from Tele-Communications, Inc., Transferor to AT&T Corp., Transferee,* CC Docket No. 98-178, FCC 99-24, Memorandum Opinion and Order, released Feb. 18, 1999.

merger would be untenable if TCI were forced to provide open access to competing Internet service providers. Ameritech suspects that AT&T will suffer a severe case of amnesia in this proceeding, but the laws of economics do not change from month-to-month or carrier-to-carrier. Unbundling requirements undeniably chill investment incentives. This is a cost that must be considered as the Commission crafts unbundling requirements that further the Act's purposes.

Finally, in addition to impeding facilities-based competition and innovation, unbundling requirements impose significant administrative costs. These include not only the costs of regulation – establishing, overseeing, arbitrating, and adjudicating unbundling requirements – but other costs as well, including network-related costs. These network costs can be substantial, particularly since, under existing regulatory policies, competitors need not commit even to using an unbundled element they have requested, much less commit to a sufficient volume of purchases as to cover costs. These rules thus provide competitors with the ability to raise their rivals' costs at no cost to themselves.

In short, as the Commission reconsiders the meaning of section 251(d)(2), it must give proper weight to the costs associated with mandatory unbundling requirements. In particular, it must fundamentally reconsider the approach taken in the *Local Competition Order*, wherein the Commission opted for rules that promote fast and easy entry, rather than rules that promote meaningful competition, investment, and innovation. As Justice Breyer notes, that approach is not faithful to the purposes of the Act and "risks costs that ... may make the game not worth the candle."[66]

---

[66] *AT&T*, 119 S. Ct. at 754 (Breyer, J., concurring).

b. The Essential Facilities Doctrine Should Inform the Commission's Interpretation of Section 251(d)(2).

The principles discussed above – that consumers benefit from policies that promote competition, not competitors, and that mandatory sharing carries with it costs that must be balanced against its benefits – are not new principles. Both of these principles have long been recognized by economists, antitrust scholars, courts, and regulatory agencies. They are embodied, in particular, in the essential facilities doctrine.

The essential facilities doctrine is an antitrust doctrine that addresses the obligation of a monopolist to make its "essential facilities" available to competitors. Although the doctrine has been articulated over the years in a number of different ways, each articulation voices a core set of principles.

According to Areeda and Hovenkamp (the treatise cited in the Supreme Court opinion), a facility is "essential" under the "essential facilities doctrine" only if each of the following conditions are met: (1) the facility or resource is essential to a competitor's viability in the market; (2) a competitor cannot practically or reasonably duplicate the facility or obtain it from another source; and (3) failure to provide or share the facility poses a substantial threat to market competition, or makes it unlikely that the market will become more competitive.[67]

As explained by Areeda and Hovenkamp, the first prong of this test is satisfied only if the competitor could not compete profitably without it. The second prong is satisfied only if the facility cannot be obtained from other sources or self-provisioned.[68] In this regard, the mere fact that the facility is costly to reproduce or that access would benefit the competitor or increase its

[67] *Areeda,* ¶771b at 201-07 (citations omitted).

[68] *Id.*

profits is irrelevant. Likewise is the fact that the monopolist may enjoy a cost advantage with respect to that facility.[69] The third prong of the test is satisfied only if access to the facility is essential to *competition* in the relevant market. It is not satisfied merely because access is essential to the viability of a particular competitor.[70]

In its opinion, the Supreme Court declined to address whether section 251(d)(2) codifies the essential facilities doctrine *per se*.[71] Perhaps the reluctance of the Court to address this issue turned on the fact that the Court had never formally adopted the essential facilities doctrine. Perhaps it had something to do with the varying articulations of that doctrine, or confusion engendered by what seemed to be two standards in the statute – a necessary standard and an impair standard.

In fact, however, the Court *did* effectively embrace the fundamental precepts of that doctrine. Specifically, in concluding that the Commission erred by "blind[ing] itself to the availability of network elements outside the incumbent's network,[72] the Court echoed a long line of essential facilities cases which hold that a requested input need not be shared if it can be practically or reasonably obtained from another source or self-provided.[73] Similarly, in finding that the Commission had improperly assumed that "any increase in cost (or decrease in quality)

---

[69] *Id.*

[70] *Id.*

[71] *AT&T*, 119 S. Ct. at 734.

[72] *Id.* at 735.

[73] *MCI Communications Corp. v. AT&T*, 708 F.2d 1081 (7th Cir. 1983);International *Audiotext Network v. AT&T*, 839 F. Supp. 1207 (S.D.N.Y. 1994), *aff'd*, 62 F.3d 69 (2nd Cir. 1995); *Illinois ex rel. Hartigan v. Panhandle E. Pipeline Company*, 730 F. Supp. 826 (C.D. Ill. 1990), *aff'd* 935 F.2d 1469 (7th Cir. 1991), *cert. denied, 502 U.S. 1094 (1992); Directory Sales Management Corp. v. Ohio Bell Telephone Co.*, 833 F.2d 606 (6th Cir. 1987). *See also Areeda* at ¶773b2, p. 205.

imposed by denial of a network element"[74] warrants unbundling – and in suggesting that an increase in cost or decrease in quality warrants unbundling only when the entrant cannot compete without access to the incumbent's facilities[75] - the Court effectively embraced the essential facilities principle that a plaintiff "must show more than inconvenience, or even some economic loss; he must show that an alternative to the facility is not feasible."[76] And finally, in directing the Commission to interpret section 251(d)(2) with reference to the purposes of the Act, the Court effectively adopted the third prong of the essential facilities test, which holds that mandatory sharing should only be required as necessary to promote *competition*, as opposed to individual competitors.

As Gertrude Stein once wrote, "a rose is a rose is a rose."[77] While the Court may not have labeled its analysis an essential facilities analysis, that is, in fact, precisely what, at its core, it was.

Moreover, putting the Court's opinion aside, there are compelling independent reasons for the Commission to look to the essential facilities doctrine in applying section 251(d)(2). That doctrine is, after all, a test for identifying the circumstances under which compulsory sharing of facilities will promote competition, innovation, and investment to enhanced consumer welfare. Its purposes, therefore, are identical to the purposes of the Act, and of section 251(d)(2) in

[74] *AT&T*, 119 S. Ct. at 735.

[75] *Id.* at 735.

[76] *Twin Labs v. Wieder Health and Fitness,* 900 F.2d 566, 569 (2d Cir. 1990). *See also Alaska Airlines, Inc. v. United Airlines, Inc.*, 948 F.2d 536, 544 (9th Cir. 1991), *cert.denied,* 112 S.Ct. 1603 (1992) (rejecting essential facilities claim because denial of access would only impose a financial burden on excluded competitors, not eliminate them); *Florida Fuels, Inc.v. Belcher Oil Co.*, 717 F. Supp. 1528, 1533 (S.D. Fla. 1989) (holding that it is insufficient for a plaintiff to allege access to one facility is simply more economical than other alternatives because "although expensive in absolute terms, the cost of duplication may be reasonable in light of transactions that would be duplicated and the possible profits to be gained").

[77] Gertrude Stein, *Geography and Plays*.

particular.[78] Moreover, the fundamental precepts of the essential facilities doctrine have been applied for nearly a century. During this time, the essential facilities doctrine has effectively been the *only* test addressing when mandatory sharing of monopoly facilities promotes these goals. Nothing in the 1996 Act requires the Commission to reinvent the wheel now.

To the contrary, the legislative history of the 1996 Act strongly suggests that Congress had the essential facilities doctrine in mind when it adopted the unbundling requirement in section 251. In describing that requirement in the House Report accompanying H.R. 1555, a precursor to the 1996 Act, Congress made explicit reference to "essential facilities:" "[B]ecause of their government-sanctioned monopoly status, local providers maintain bottleneck control over the *essential facilities* needed for the provision of local telephone service." [79]

CLEC representatives, testifying before Congress on the need for this legislation, also made specific reference to "essential facilities." For example, in urging Congress to eliminate barriers to entry in the local exchange market, Heather Gold, then-President of the Association for Local Telecommunications Service (ALTS), specifically testified that "[a]ll carriers that control *essential bottleneck facilities* [should] make *those facilities* available to other carriers on

---

[78] To be sure, the essential doctrine has been fundamentally an antitrust tool, rather than a regulatory tool. That, however, is a distinction without a difference:

> Theoretically, governmental regulation and antitrust laws may be viewed as flip sides of the same coin; "regulation is an alternative to antitrust" laws, as both focus on a competitive goal. ... [T]he goal of the regulatory interconnections mandate of the [1996] Act is to foster competition in the telecommunications market. The antitrust laws are recognized by scholars and the judiciary as a vehicle for achieving competition in markets.

Elizabeth A. Nowicki, *Competition in the Local Telecommunications Market: Legislate or Litigate?,* 9 Harv. J. Law & Tech. 353 (1996) at Section V.A. (quoting Stephen G. Breyer, *Regulation and its Reform* 156-61 (1982).

[79] H.R. Rep. No. 204, 104th Cong. 2d Sess. at 49 (1995) (emphasis added). An earlier House Report set forth Congress' understanding of the essential facilities doctrine: "The essential facilities antitrust doctrine applies where one firm controls a facility *for which duplication is infeasible* and denies a second firm reasonable access to that facility, thereby inflicting severe hardship." H.R. Rep. No. 103-559, at 109 n. 180 (1994) (emphasis added).

a nondiscriminatory, unbundled basis, at cost-based rates."[80] Neither ALTS, nor any other proponent of the unbundling provisions of the Act ever suggested that ILECs should be required to make *non*-essential facilities available at cost-based prices. The unbundling provision of the Act directly responds to the CLECs' concerns by requiring ILECs to make available network elements that are essential to competition in the local exchange market, on an unbundled basis, and at cost-based rates.

Under these circumstances, the Commission cannot ignore the essential facilities doctrine in its analysis of section 251(d)(2). In light of the Court's decision, the purposes of that doctrine, its established place in antitrust jurisprudence, and the legislative history of the unbundling provisions of the Act, the essential facilities doctrine should guide, if not control, the Commission's interpretation of section 251(d)(2).

IV. Meaning of the Necessary and Impair Standards.

a. Section 251(d)(2)(B) - The Impair Standard.

Based on the foregoing, it is evident that the best way – indeed, the only way - to enhance consumer welfare through increased competition and investment, consistent with the goals of the 1996 Act, is to require unbundling only in those circumstances in which it is necessary for viable competition. That is, in fact, precisely what section 251(d)(2)(B), by its terms, requires.

Section 251(d)(2)(B) provides that "[i]n determining what network elements shall be made available, the Commission shall consider, at a minimum, whether ... the failure to provide

[80] *National Communications Infrastructure: Hearings Before the Subcommittee on Telecommunications and Finance of the House Committee on Energy and Commerce,* 103rd Cong., 1st Sess. 77 (Jan. 19, 1993) (emphasis added).

access to such network elements would impair the ability of the telecommunications carrier seeking access to provide the services it seeks to offer."[81]

In the *Local Competition Order*, the Commission misconstrued this provision. Focusing exclusively on the meaning of "impair," and relying on a dictionary that included in its definition of "impair" the phrase, 'diminish in value,' the FCC found that "an entrant's ability to offer a telecommunications service is "diminished in value" if the quality of the service the entrant can offer, absent access to the requested element, declines and/or the cost of providing the service rises."[82]

The FCC's textual analysis was flawed in two respects.[83] First, the *Random House College Dictionary* notwithstanding, the ordinary meaning of the term "impair" is not to diminish *in value*; it is to impede, or, as stated in *Webster's Ninth New Collegiate Dictionary*, "to damage or make worse as if by diminishing in some material respect."[84] Second, in focusing entirely on the word "impair," the Commission ignored the two words that follow it: "the ability." These two words require that the impairment relates to the *ability* of the carrier to provide the services in question. If a carrier is damaged or inconvenienced in some way in its provision of services – for example, by diminished profits or diminished quality - but is not impaired in its *ability* to provide those services, it does not meet the section 251(d)(2)(B) standard, and the Commission was incorrect to hold that it does. In order to meet the section

[81] 47 U.S.C. § 251(d)(2)(B).

[82] *Local Competition Order,* 11 FCC Rcd at 15643, para. 285, citing *Random House College Dictionary* 665 (rev. ed. 1984).

[83] Even Justice Souter, the only justice to have found that the FCC's reading of the "impair" standard survives Chevron scrutiny, conceded that the FCC construed this term in its "weak sense." *AT&T* at 740 (Souter, J., (concurring in part and dissenting in part).

[84] *Webster's Ninth New Collegiate Dictionary, 1991; see also Pocket Oxford Dictionary,* 5th Edition, 1969.

251(d)(2)(A) test, the carrier must show that the lack of access to an ILEC facility would affect its ability to offer the services it seeks to offer.

Of course, in referring to the "ability" of a requesting carrier to provide services, Congress was not using that term in its strictest sense. The issue is not just whether CLECs have the "technical" ability to provide services with alternative facilities. The issue, rather, is whether they have the practical ability to do so – *i.e.*, whether they could earn a normal economic profit if they use alternative facilities. If the answer is yes, then they are not impaired in their ability to offer those services; if the answer is no, they are impaired, and they are entitled to use non-proprietary ILEC facilities.

Significantly, this textual analysis of section 251(d)(2)(B) comports, not only with sound public policy and essential facilities precedent, but with the analysis of the Supreme Court. In the exchange between Justices Souter and Scalia about ladders and light bulbs, Justice Scalia, writing for the majority, observed that the lack of a particular ladder does not impair one's ability to change a light bulb if, using another ladder, and stretching one's arms to full extension, one could change the bulb. By the same token, the lack of access to ILEC network elements does not impair the ability of CLECs to provide services if they can provide those services using alternative facilities.[85]

In addition to addressing whether CLECs can earn a normal economic profit without access to ILEC network elements, the "impair" test also addresses whether CLECs require ILEC

---

[85] In considering whether a reasonably efficient CLEC can earn a normal economic profit without access to ILEC network elements, the Commission may not consider whether the CLEC could earn a higher profit if it is able to purchase access to ILEC network elements at TELRIC rates. The text of section 251(d)(2)(B) makes that clear by referring to the "*ability*" of a CLEC to offer the services it seeks to offer. The Court, as well, made that clear in holding that the focus of the Commission's analysis must be whether a reasonably efficient CLEC can "reach the light bulb" without access to the ILEC's ladder, not whether it would be easier to do so with that ladder.

facilities in order to enter the market in a reasonably timely fashion. If they do, then the pro-competitive policies of the Act would not be fully served by denying them access to ILEC network elements, even if those CLECs could ultimately earn a normal economic profit by deploying their own facilities.

The DOJ/FTC Merger Guidelines provide guidance as to how long a period is reasonable.[86] Those guidelines consider potential "committed" entrants to be viable if those potential entrants will be able to "achieve a significant impact on price" within two years of planning the entry. The Commission, as well, has recognized the relevance of a two year time frame in assessing the viability of competitive entry. For example, in reviewing the MCI/WorldCom merger, the Commission found that in most of the relevant markets, there was a likelihood of substantial entry within a two-year time horizon.[87] Consistent with this precedent, the Commission should find that a CLEC is not impaired in its ability to provide a service, based on considerations of delay, if it can deploy alternative facilities within two years of its decision to do so.

This two-year time frame simply requires that entry be possible within two years and that entrants have a business case with a positive net present value at the time they enter. Stated differently, it requires that, at the time of entry, the total discounted present value of revenues over the entire forseeable life of the investment exceed the total discounted present value of its costs.[88] It does not require, however, that entrants turn cash-flow positive or achieve any other

---

[86] *See Department of Justice and Federal Trade Commission Horizontal Merger Guidelines,* April 2, 1992, § 3.0.

[87] Application of WorldCom, Inc. and MCI Communications Corp. for Transfer of Control of MCI Communications Corp. to WorldCom, Inc., CC Docket No. 97-211, released Sept. 14, 1999, at paras. 36, 101, 105, 114, and 151.

[88] *See* Aron/Harris Affidavit at 42.

short-run profit criteria within any specific time frame. New entrants in established markets frequently do not earn a profit in their initial years of operation; that does not mean, however, that these are not viable entities. Indeed, there are countless Internet companies that are deemed more than viable by Wall Street investors but which have yet to turn a profit.

Finally, and as discussed above, in assessing the need of a new entrant for ILEC facilities – *i.e.,* whether, absent those facilities, the new entrant would be unable to enter the market within a reasonable time frame or to earn a normal economic profit in its provision of services - the touchstone must be the requirements of a reasonably efficient competitor. The purposes of the Act are not furthered by promoting mass entry by inefficient competitors who bring little to the market in terms of resources and know-how. Consumer welfare is enhanced only by entry into the market of reasonably efficient competitors – *i.e.,* those who have the capacity to drive lower prices, higher quality services, innovative new offerings, and investment in new infrastructure.

Indeed, any other frame of reference would be impossible to implement. Neither this Commission nor state arbitrators is in a position to evaluate the needs of every potential entrant for every network element on a case-by-case basis. Therefore, *some* uniform frame of reference must be established. Public policy and the purposes of the Act require that this frame of reference be the needs of a reasonably efficient competitor.

Tying all of this together, Ameritech proposes the following test for applying the "impair" standard under section 251(d)(2)(B):

> *Unbundling of a nonproprietary network element is required if the lack of access to that element would prevent a reasonably efficient competitor from providing the services it seeks to offer within two years and from earning a competitive return on capital (i.e., a normal economic profit) in the provision of those services over the life of its investment.*

Ameritech also proposes below bright-line standards to facilitate implementation of this test.

b. Distinction Between Section 251(d)(2)(A) and 251(d)(2)(B).

Section 251(d)(2) contains two sub-parts – subsection (A), which applies a "necessary" test for "such network elements as are proprietary in nature," and subsection (B) which establishes the "impairment" test discussed above for "such network elements." Clearly, the purpose of subsection (A) is to establish a higher level of scrutiny for proprietary network elements than for nonproprietary network elements. In this subsection, Ameritech discusses how the Act achieves this goal.

As an initial matter, the different treatment of proprietary and nonproprietary elements does not arise from any distinction between the concepts of "necessity" and "impairment." The Supreme Court itself did not draw any substantive distinction between these two concepts,[89] and Ameritech does not believe that any such distinction can be squared with sound economics or the text of the statute.

As noted, the Act's goals of promoting competition and innovation dictate that unbundling be required only when access to an incumbent's facilities is essential for a reasonably efficient competitor to earn a normal economic profit. While a stricter standard for proprietary elements might be justified on public policy grounds (on the same basis as patents), a stricter standard would deny access even if a reasonably efficient competitor could not, as a practical matter, compete without a particular proprietary element. Such an approach would be difficult to square with the statutory language. At the same time, a more lenient reading of the impair test would reduce competition and impede investment in direct contravention of the goals of the Act.

[89] As discussed above, the Court concluded that, under both standards, the Commission could not "blind itself to the availability of elements outside the incumbent's network." *AT&T*, 119 S. Ct. at 735. Similarly, it held that the Commission could not assume that "any increase in cost (or decrease in quality) imposed by denial of a network element renders access to that element 'necessary,' or causes failure to provide that element to 'impair' the entrant's ability to furnish its desired service." *Id.*

It would also ignore the text of section 251(d)(2)(B), in particular, the words "the ability." That, too, is untenable.

Therefore, instead of distinguishing section 251(d)(2)(A) and (B) with reference to the meaning of "necessary" and "impair," the Commission should take a different approach – a approach that better squares both with the statutory language and public policy. Specifically, the Commission should recognize that, while the substantive analysis under the necessary and impair tests is the same, the necessary test is a more focused test - a test that zeroes in on the proprietary features, functions, and capabilities that may be housed within an otherwise nonproprietary network element. Ameritech explains this distinction and why the statute requires it below.

The key to understanding the distinction between section 251(d)(2)(A) and (B) lies in two statutory provisions: section 251(d)(2) itself, and section 3(29), which defines network elements. Section 251(d)(2) provides that:

In determining what network elements should be made available for purposes of subsection (c)(3) of this section, the Commission shall consider, at a minimum, whether –

> *(A) access to such network elements as are proprietary in nature is necessary; and*
>
> (B) *the failure to provide access to such network elements would impair the ability of the telecommunications carrier seeking access to provide the services it seeks to offer.*

As is clear from the language of this provision, the necessary standard applies only to "such network elements as are proprietary in nature." Section 251(d)(2)(B), by contrast, contains no modifier or other limitation, but rather refers back to the phrase "what network elements should be made available" in the opening clause. Therefore, the impair standard applies to *all* network elements, proprietary and non-proprietary, while the necessary standard applies uniquely to proprietary elements.

What this means, of course, is that proprietary network elements face a double hurdle: they must pass the impair test and the necessary test. Here, again, the statute itself – in particular, the statutory definition of network elements - provides the key.

The term "network elements" is defined in the Act to encompass not only (i) a facility or equipment used in the provision of a telecommunications service, but (ii) *features, functions, and capabilities that are provided by means of such facility or equipment.*[90] Thus a network element includes both the facility or equipment itself and its features, functions, and capabilities. As seen in this light, Section 251(d)(2) simply requires that when either the features, functions, and capabilities or the facility or equipment itself are proprietary, those aspects of the network element that are "proprietary in nature" are subject to separate scrutiny under the necessary test. The first line of scrutiny, of course, is whether the facility itself must be provided. Assuming the facility is non-proprietary, that facility is reviewed under the impair test. If any of the features, functions, and capabilities of that facility, however, are proprietary, a second review must occur to determine whether those proprietary features, functions, and capabilities must be provided along with the underlying facility itself. That second review asks the question whether the proprietary features, functions, and capabilities are necessary to the operation of the nonproprietary element and, if so, whether the CLEC can obtain an alternative source, including through self supply.

This point is best illustrated by an example. As noted above, the routing table is a proprietary feature of switching equipment. It is a software application that is housed within the

[90] 47 U.S.C. § 153(29).